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NO. 653

IN THE

Supreme Court of the United States

GAS RIDGE, INC.,
Petitioner.

v.

SUBURBAN AGRICULTURAL PROPERTIES, INC.,
Respondent.

PETITION OF GAS RIDGE, INC., FOR REHEARING

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FIRM FOUNDATION—AUSTIN

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To the Supreme Court of the United States:

It is with considerable diffidence that petitioner seeks a rehearing of the judgment of this Honorable Court denying certioari in the above cause, entered on January 28, 1946.

However, in view of its earnest conviction that under the conceded facts the decision of the Circuit Court construing the legal effect of the contract involved is in conflict with decisions of the Supreme Court of Texas *in W. T. Waggoner Estate* v. *Sigler*

Oil Co. (19 S. W. (2) 27; *Watson* v. *Rochmill* (155 S. W. (2) 783; and *Decker* v. *Kirlicks* (216 S. W. 385); and because of the paramount importance of the issue to stripper lease operators in Texas and in other jurisdictions, petitioner feels justified in requesting the Court's indulgence to reexamine the controlling law questions in the case.

THE FIRST ASSIGNMENT OF ERROR

The Circuit Court said (emphasis added): "The opinion of the Supreme Court in Garcia's case (164 S. W. (2) 509) leaves in no doubt: that 'production' as used in the lease in question means 'production in paying quantities'; that the continuation in force of the lease depended on the continuation of such production; and that *when* that ceased, the lease *automatically* terminated."

Thus, the Circuit Court gave an effect to the decision of extending beyond the primary term the condition there implied, whereas the Texas Supreme Court specifically restricted such implication to the condition in this respect existing at the *end* of the fixed period; and necessarily so, as petitioner urges, because to project such implication beyond said definitely provided date would rest an implied limitation of title upon "the existence or nonexistence of a state of facts not clearly defined," which will not be done in support of forfeiture *Benavides* v. *Hunt* (Tex. Sup., 15 S. W. 396; *Waggoner* v. *Sigler*, supra).

As clearly shown by respondent's Complaint and the trial court's Findings, Conclusion and Judgment, neither could within a range of one to fifteen years determine when the event occurred which had the effect of *automatically* putting an end to petitioner's title, a situation in respect of which the Texas Supreme Court has said it should not be concluded "that the parties intended to prescribe a test for termination of the interests granted which could only be applied with the utmost uncertainty or confusion," and that under such conditions "neither lessor nor lessee could at any time have clearly or certainly known whether the estate granted was alive or ended" (*Waggoner* v. *Sigler*, supra).

There would appear to be no reasonable basis for the conclusion that an event the occurrence of which in relation to time is shrouded in uncertainty can be said to have had an automatic effect, a proposition which upon its face manifestly involves a contradiction. Yet, this legal incongruity must be resorted to if the conclusion of the Circuit Court is to be sustained, that " 'production' as used in the lease in question means 'production in paying quantities' ", despite the fact that respondent made no effort whatsoever to establish that the lease here involved was not productive of oil or gas in paying quantities when its primary term ended on December 7, 1925.

It would seem illogical and unsound, upon the authority of *Garcia* v. *King*, not only to impute to the contract in question here a non-existent condition

of defeasance, but to presumptively extend such imputation by its tortured application to wholly dissimilar conditions. Thus would presumption be piled upon implication, to accomplish what? The destruction of a vested estate by resort to the disfavored remedy of forfeiture, a right which respondent was required to sustain by clear, certain and convincing proof *(Decker* v. *Kirlicks* (Tex. Sup.), 216 S. W. 385).

But there is still another decisive reason why the implied limitation of title "in paying quantities" should not, upon the authority of *Garcia* v. *King*, be read into the lease here involved. In the case at bar the contract contained the express covenant that after completion of the exploratory well the lessee "*shall continue the development of said property until said property has been reasonably developed.*" What was the plain purpose of this clause, which was in no sense one of defeasance because there was no condition of forfeiture attached to non-compliance? Obviously, it was to furnish contractual assurance, in the nature of a covenant, that royalty returns would be as high as reasonably possible viewed in the light of surrounding conditions when the agreement was made. Did the breach of such an obligation render the lessor remediless? And did it not, being expressed, dictate the exclusive recourse of the lessor for its alleged breach? The answers are found in *Waggoner* v. *Sigler*, where it is said that the usual remedy for breach of a covenant for reasonable development is an action for damages, or alternatively, where there can be no other

adequate relief, a court of equity will entertain an action to cancel the lease in whole or in part. And it will be noted in this respect that respondent does not even assert that it could not thus have been fully and adequately compensated and protected for any breach by petitioner of its express covenant for reasonable development. Respondent's choice of remedies was deliberate, witnessed by the studied difference in these respects between its abandoned and trial complaints (R. 2-16).

Respondent thus chose a remedy which, rightfully, is not favored in the law *(Nelson* v. *Downtain* et al. (Tex. Sup.), 265 S. W. 135), thereby assuming the heavy burden of bringing itself precisely within the rules of law which would cause an automatic reversion to it of petitioner's vested estate and rights, as against another which would more fairly assure to both parties their rightful dues. After, all, the law is but the rule of reason, which apparently does not accord with the conduct of a party with two avenues of procedure open who selects one which cannot be sustained save by building presumption upon implication and which has the effect of wiping out another's investment and estate.

It has been repeatedly declared by the Supreme Court of Texas that a contract will be construed in accordance with its plain language (10 Tex. Jr., Sec. 163, p. 279; *Cooley* v. *Buie*, 291 S. W. 876); and that the terms of the agreement, when free from ambiguity and not in conflict with the policy of the law, establish the rights of the parties (id.; *Burns*

v. *National Life Ins. Co.*, 280 S. W. 762), citing *Insurance Co.* v. *Coos County*, 14 S. Ct. 379; 151 U. S. 452, 38 Law. Ed. 231, where this Court said:

"It is immaterial to consider the reasons for the conditions or provisions on which the contract is made to terminate, or any other provision of the policy which has been accepted and agreed upon. It is enough that the parties have made certain terms, conditions on which their contract shall continue or terminate. The Courts may not make a contract for the parties." Nor may the courts by refinement of construction nor by interpolation of absent terms devolve an intent from the agreement contrary to that which is plainly expressed (*Reynolds* v. *McMan Oil Co.*, 11 S. W. (2) 778; on rehearing, 14 S. W. (2) 819).

It is most earnestly submitted that the Garcia case does not sustain the Circuit Court's interpretation of the contract here involved, and that its final affirmance will have a devastating effect upon the operators of stripper leases throughout Texas in relation to the title status of oil and gas offered for market therefrom, with the inescapable result, as soundly recognized by the Supreme Court of Texas in the Waggoner case, that "such a test must inevitably diminish—if not destroy—the value of the rights of all parties derived from a mineral lease."

The vital importance of a clear distinction between the automatic ending of a lease grounded on a limitation precisely ascertainable and the breach

of an express or implied covenant compensable in damages in relation to the title of oil or gas offered for market is emphasized by the Texas Supreme Court in *Freeport Sulphur Co.* v. *American Sulphur Royalty Co.* (6 S. W. (2) 1039), referred to by the court in *Waggoner* v. *Sigler* with the observation that "no damages could be properly awarded the lessor for any failure by the lessee to drill for or protect or market minerals *after they had reverted to the lessor under the operation of a limitation on the lessee's estate* (emphasis added). "Both decisions (*Texas Pacific Coal & Oil Co.* v. *Barker* (Tex. Sup.) 6 S. W. (2) 1031) necessarily imply that the obligations breached were covenants and not limitations."

And while it is true, as thus observed, that the lessor under the conditions stated could not recover in damages for breach of the development obligations, it necessarily follows, if the decision of the Circuit Court in the case at bar is to be upheld, that petitioner will be in the position, as will other similarly situated lessees, *of having converted all of the oil and gas taken after the automatic reversion of the leasehold estate to the lessor*, an inescapable result which underlies and emphasizes the unfailing refusal of the Supreme Court of Texas to sustain the contention that breach of an obligation to develop will operate as a limitation upon the title.

The Circuit Court says, basing its conclusions on the Garcia case, that the lease here in question automatically terminated *when* it ceased to measure up to the implied condition of production of oil or gas

in paying quantities. The Circut Court had no information of *when* this condition resulted, because neither respondent nor the trial court knew within a period of from one to fifteen years, during all of which time, however, as the Circuit Court interprets *Garcia* v. *King*, petitioner necessarily was guilty of converting respondent's oil and gas, in that it had lost title thereto, and would be liable therefor in damages at the later suit of respondent when it might convince court or jury that the conversion commenced and continued from a date certain.

Nor would petitioner be alone in this predicament. Based upon the decision of the Circuit Court, every other similarly situated stripper lease operator would labor under the same hazard, with no idea when his lessor might conclude that the time was propitious for him thus to collect.

Petitioner will not prolong the discussion under this assignment, except to again recall that it was expressly held in the Garcia case, as bearing decisively upon proper interpretation of the opinion, that because of development postdating termination of the primary term the lease was commercially productive when the case was tried, but that such circumstance would avail the lessee nothing *because his estate had ceased to exist when the term ended*, which induces the thought that turn about should be fair play. If, upon the theory of automatic reversion, posterior development operations of the lessee become irrelevant, application of this rule, invoked by respondent in reliance upon *Garcia* v. *King*, would

render wholly immaterial all evidence offered by it relating to petitioner's activities since December 7, 1925, when the primary term of the lease here involved expired.

If, as asserted by respondent and the Circuit Court, the principles announced by the Texas Supreme Court in *Garcia* v. *King* are sound as applied to the case at bar, it is difficult to follow reasoning which would attribute to alleged lack of commercial production occurring *after* the primary term the effect of an automatic ending of petitioner's title. Respondent pitched its case upon the automatic cessation of petitioner's title. The trial court so found and adjudged, although obviously uncertain of when the event occurred, as was respondent itself. The Circuit Court expressly approved such findings and conclusions, with the same attendant uncertainty. In developing its theory, respondent introduced a mass of evidence none of which even purported to relate to conditions existing on December 7, 1925, when the primary term ended. In fact, the only evidence that could by the remotest stretch of the imagination bear directly upon respondent's theory was the testimony of its witness WALKER, an accountant, whose conclusions, based upon petitioner's income tax returns, were confined to the years 1941, 1942 and 1943 (R. 152, 154, 155). Respondent's suit in the state court was filed November 8, 1941 (R. 181). It is not even contended that the testimony of respondent's other witnesses related to conditions save those existing immediately prior to the trial.

Thus, in the light of the decision upon which respondent and the Circuit Court rely, the evidence adduced by the former is without relevance to the determinative question involved, as respondent elected to ground its case, i. e., was there *when the primary term ended* a lack of commercial production of oil or gas, to afford a legal basis for adjudging its automatic termination?

Petitioner most earnestly submits that no Texas decision supports such a conclusion, and that the true rule applicable to the undisputed facts here is announced in *Waggoner* v. *Sigler*, *Watson* v. *Rockmill* and *Decker* v. *Kirlicks*, each of which petitioner has attempted to analyze in the preceding discussion and in the petition for certiorari.

THE SECOND ASSIGNMENT OF ERROR

This is the first instance within petitioner's information in the judicial history of the natural gas industry that a lease has been cancelled on the ground of its commercial unproductivity under conditions where it is conceded that gas had been regularly produced from it and marketed for more than a decade through an established pipe line, resulting no doubt from the circumstance that hitherto it had never occurred to any lessor that the commercial productivity of a lease so conditioned could be questioned. In all of the cases to which petitioner's attention has been directed in this respect the issue arose where gas in substantial quantities had been

discovered but no market was available and no outlet had been provided prior to termination of the fixed term. In many such leases there was contained a specific provision for production of oil or gas in paying quantities. But, whether or no, it has uniformly been held that when the stated period ended and the lessee was not actually marketing gas, whether for lack of pipe line connection or otherwise, the estate automatically terminated.

Establishment of the principle that regular deliveries of substantial amounts of gas to an established pipe line is conclusive of the commercial productivity of the lease from which it is taken is vitally essential to the independent producer. Otherwise, as petitioner will endeavor to show, the lessor is placed in the position to cancel the lease almost at will, particularly after expiration of the defined duration period.

Such a producer has no control over well spacings, a responsibility confided to public authority. Unlike the producer of oil, he has no voice in the quantity of gas which the purchaser might elect to take within the maximum limits provided by law. The oil producer can resort to truck transportation if no pipe line is available, or if the terms and price offered are unsatisfactory. But the gas producer is dependent wholly upon pipe line transportation. If it should happen that his lease consists of only 640 acres and is situated in a territory where he may not lawfully drill more than one gas well thereon and is probably only one of hundreds of other producers

from whom the purchaser secures its market requirements, or however else he may be situated, there is nothing for him to do but accept what the fates decree.

In short, the independent producer of natural gas is peculiarly the subject, and quite frequently the victim, of public and private regulation. But his lessor is governed by the same statutory and economic laws. In the very nature of the gas business the purchaser cannot buy in large volume from a particular well or lease, not only because of the conservation laws and the rules of regulatory bodies, but based upon the practical necessity of maintaining great reserves to meet the exigencies of market requirements, the economic foundation for important securities payable over a long period of years, thus foreclosing the possibility that returns from the sale of gas to any one such producer can be much more than a "pittance," measured by the large profits received from oil production.

In most instances, particularly in the Southwest, the independent producer does not deliberately drill a gas well because of prevailing low at-the-well prices. When such does result, usually in connection with oil exploration, it is considered untoward, but better than nothing, in that the returns will necessarily be small, perhaps insignificant, compared to the cost of drilling and completing the well, although with the saving prospect of continuance over many, many years and the more important controlling consideration that there is no expense

attached to its production and marketing. After his well has been connected to the pipe line, any volition on the part of the producer ends. Both he and his lessor receive their periodical checks from the purchaser pursuant to required division orders, with which the chapter endeth until the well permanently ceases to produce.

Most, if not all, of these considerations are judicially known to the Court *(Reynolds* v. *McMan Oil & Gas Co.* (Tex. Supreme), 11 S. W. (2), 778, 784). This Court upon many occasions, in relation to the gas industry in Texas, has upheld the principle that private rights will be subordinated to a reasonable exercise of the state's police power, so peculiarly necessary in the production and marketing of natural gas (Consolidated cases, 300 U. S., 55; 57 Sp. Ct., 364; 81 Law Ed., 510-24).

The declared primary purpose of Texas natural gas conservation enactments (Vernon's Texas Civil Statutes. Arts. 6008 et seq., at p. 192; and Arts. 6050 et seq., at p. 287), pursuant to constitutional authorization (Art. 16, sec. 59a) was to prevent above or *underground* waste of this irreplaceable product, with the result that in the absence of some compelling operational reason the Texas Railroad Commisison in its administration of the Natural Gas Act will not permit disconnection of gas wells from pipe lines if the consequence will be to leave in the ground unproduced and unproducible natural gas which the pipe line is willing to take and market. Not only that, but it would appear to be an unjustified eco-

nomic waste to bring about any such result at the suit of a lessor who deliberately elects that course over the less harsh remedy of a suit for damages, if the lessee had in fact been derelict in performance of the covenant to reasonably develop.

Wherefore, petitioner most earnestly urges that the decision of the Circuit Court in this case will be greatly injurious in its effect upon the title status of literally thousands of independently operated gas leases in Texas, and will raise a most serious question of the lawful marketability of natural gas therefrom. The ramifications of the natural gas industry have to such an extent become nation-wide and are so interrelated with many other phases of the national economy that the questions reflected by this record therefore assume a general importance peculiarly justifying their authoritative determination by this honorable Court.

Copies of the within petition for rehearing have this February ....., 1946, been mailed to Knox Miller, Esq., Alamo National Building, San Antonio, Texas, attorney for respondent, for use of himself and associate counsel.

WHEREFORE, because of the matters hereinbefore and in its petition for certiorari set forth, petitioner prays that a rehearing be granted, and that there-

upon the Court will accord it such relief as the record may justify.

Respectfully submitted,

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Certificate of Good Faith

The Attorney presenting this petition for rehearing certifies that the same is presented in good faith and not for delay.

ARTHUR H. BARTELT
Attorney for petitioner.